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The Present Railroad Situation

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The Present Railroad Situation

SPECIAL REPORT NUMBER 23

National Industrial Conference Board

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National Industrial Conference Board

10 EAST 39TH STREET, NEW YORK

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THE PRESENT RAILROAD SITUATION

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National Industrial Conference Board
10 EAST 39TH STREET
NEW YORK CITY

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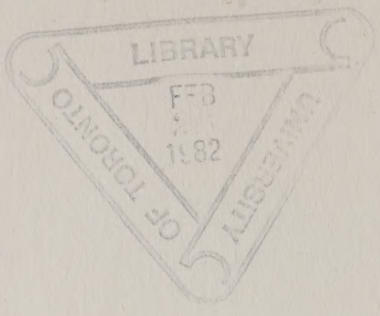
Foreword

The importance to the public welfare, and to American industry in particular, of an efficient railroad system, adequate to, and expanding with, the growing needs of the country is quite generally recognized. What has not so generally impressed itself, however, is the extent to which the solution of this problem depends upon wide and sound knowledge among the general public of the character of the problem and upon the measures by which, through their legislative representatives, they control the railroads in the common interest. In their capacities as shippers, travelers, taxpayers, workers and voters, the public determine finally the character and effectiveness of the railroad service they receive, and the value of their influence varies with the accuracy and breadth of their understanding of the railroad situation.

In response to these considerations the Conference Board has undertaken to present in this report a brief and simple statement of the essential facts of the present railroad situation. Such a statement, it is felt, may be of value in the intensive public discussion which the railroad question is destined to receive in the future.



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The Present Railroad Situation

I

INTRODUCTION

The progress and prosperity of any country, particularly of one so extensive in area and complex in economic character as the United States, depends to a large extent upon its transportation system. The United States is a country of great distances. No single section of it is self-sufficient. Raw materials and food are brought to the manufacturing districts from points of production far distant, and the sections which produce food and raw materials, in turn, receive their machinery, implements, clothing, and other manufactured goods from centers far away. Transportation, especially rail transportation, has played and will continue to play an important part in the nation's welfare.

Without the railroads, no section of the country would have reached its present state of development. This is especially true of the West. In that part of the United States the railroads were laid out first; settlement and development followed. The railroads have made possible the centralization of manufacturing in the eastern part of the United States, and of food production in the central and western parts, because they have provided relatively easy means of communication and transportation between all sections. There are about 235,000 miles of Class 1 railroads[1] and about 25,000 miles of smaller railroads in this country, the greater part of which were constructed prior to the passage of the Interstate Commerce Act of 1887. The rail mileage of the United States constitutes approximately 37% of that of the world.

For the past ten or twelve years it has become increasingly apparent that the railroads as a whole, especially in the eastern part of the country, have not expanded sufficiently to meet the increased demand for transportation, nor have they been as successful financially as the prosperity of the country generally would seem to warrant. The realization of this condition resulted

[1]A Class 1 railroad is one whose annual operating revenues are $1,000,000 or over.

in the passage of the Transportation Act of 1920 which changed some of the fundamental principles of railroad regulation. Since March 1, 1920, when the Transportation Act became effective, the railroad situation, however, has not improved in the way in which it was expected that it would. The climax came in the fall of 1922, when the railroads found themselves, on account of the then existing adverse conditions, unable to move expeditiously a volume of traffic greater than any the country had ever known. From present indications it is expected that 1923 will witness the movement of the greatest volume of traffic in American railroad history.

Especially since the termination of federal control of the railroads in 1920, many railroad labor union leaders and a group of political leaders have been urging government ownership of the railroads. The shopmen's strike of 1922 and the difficulties which the railroads encountered in the movement of the heavy freight traffic of the fall and winter of 1922, were used to give point to the advocacy of the adoption of this plan. But the people as a whole, including most of the business men, seem distinctly committed to the belief that continued private ownership and operation of the railroads will serve the country's transportation needs more adequately than government ownership. It is the contention of American railroad executives that, with normal conditions, the railroads under private management can provide satisfactory transportation service. To substantiate this belief the railroads have planned to spend over a billion dollars during 1923 for new locomotives, cars, trackage and other facilities in order to handle the heavy freight traffic which is expected to reach its peak in the fall of 1923, despite the fact that returns from operation in recent years scarcely justify such a heavy expenditure. That the railroads may be successful in their efforts to provide adequate transportation during 1923, and thus to prove that under private ownership and management they are capable of taking care of the country's transportation needs, the active cooperation of the shippers and a sympathetic understanding of the present railroad problem on the part of the public are necessary.

The railroad situation is attracting widespread attention throughout the country. Shippers in almost all sections have been complaining of high rates, delays to shipments, and a shortage of cars. At the same time the railroads' reports indi-

cate that they have not enjoyed their full share of the general prosperity of the country. Obviously, if both contentions can be supported, there is need for adjustment somewhere in the relation of the transportation system to the public. Any plan for the amelioration of the present condition necessitates an analysis of its causes, both immediate and remote; the knowledge so gained is the essential basis for working out the railroad problem.

II

SERVICE

A discussion of the immediate causes of the failure of the railroads to provide adequate service in recent years will help in an understanding of the present situation. The principal criticisms against the service of the railroads have been that a shortage of freight cars has existed from time to time and that shipments have been unduly delayed. Since the principal causes both of the shortage of cars and of delays to shipments arise from identical conditions, the two may be discussed together.

Immediate Causes

Weakened Plant and Equipment Following Federal Control

When the Government, which had taken over the operation of the railroads at the end of December, 1917, returned the roads to private management on March 1, 1920, the plant and rolling stock of the railroads were in a weak and deteriorated condition. During almost the entire year of 1918, the railroads were operated to but one end—winning the war. Maintenance of plant was neglected, and equipment was kept in operation as long as possible without repairs, in order that the maximum results might be obtained in the movement of freight and troops. After the cessation of hostilities it was thought necessary to continue government operation of the railroads until plans could be made for returning them to private management and for their subsequent regulation. Because of the uncertainty as to when the return to private operation would be made and what the conditions of the return would be, only such repair and maintenance of plant and equipment work as was absolutely necessary was carried on. Consequently, when the period of federal control was terminated, the plant and equipment of the railroads showed the effect of the lack of adequate repairs and maintenance during the preceding twenty-six months. Since March, 1920, the railroads have attempted, in the face of many obstacles and with only partial success, to bring their plant and equipment up to the level of

repair and efficiency which they occupied before federal control. The inability of the railroads to do this completely because of the low level of their net earnings during 1920, 1921, and part of 1922, and the consequent necessity of the greatest economies in operation was a factor in the large number of unserviceable cars and locomotives which existed in 1921 and 1922; and, to the extent that funds which might have been expended for additional facilities were devoted to putting the plant and equipment in the best condition possible with the means at hand, it has been a factor in the lack of adequate additional facilities for the movement of traffic.

Depression of 1921

The year 1921 was one of general depression during which freight traffic fell to a low level. Consequently, the railroads reduced operating expenses to a minimum in many directions in order to conserve their earnings. The surplus of cars reached the figure of 500,000 during 1921, the highest attained during the last five years. In view of this large surplus of cars and the low volume of traffic, and in order to keep down operating expenses, the railroads deferred the repairs of many freight cars and locomotives until a more prosperous period. During 1921, the number of cars awaiting repairs reached 375,000, the highest point in several years. This large number of unserviceable cars did not inflict any hardship on the shippers, however, because, due to the relatively low density of traffic, a large surplus of cars in good repair was available at this time.

Revival of Traffic

Late in 1921, however, industrial conditions began to improve, and the number of cars loaded increased from a weekly average of 680,000 in December, 1921, to an average of 825,000 in March, 1922. This traffic improvement continued steadily throughout 1922, except for a decline beginning in April due to the coal strike. During the month of October, 1922, a weekly average of almost 1,000,000 cars loaded was attained. Even after the October peak the car loadings of 1922 were in excess of those for the same period of 1920, which was the previous record year, and the loadings during the first seven months of 1923 have been the greatest in American transportation history for that period of the year.

Shopmen's Strike

Although the volume of traffic was increasing rapidly in 1922, there was a large number of cars and locomotives awaiting repairs which were deferred from the period of the depression of 1921. This situation became accentuated when, on July 1, 1922, the railroad shopmen's union called a strike in protest against a wage reduction ordered by the United States Railroad Labor Board. Practically all the railroads attempted to meet the resulting situation by recruiting new forces to replace the strikers. The work of gathering new repair crews was necessarily difficult, because in view of improving industrial conditions the labor supply was not abundant, and because many workers were reluctant to enter railroad service for fear that the settlement of the strike would cause their early displacement. Repair work with an incomplete and inexperienced force was consequently slow. On and subsequent to October 1, 1922, many roads settled with and took back their striking shopmen and some of these roads retained that part of the new force which was proving efficient.

The direct cost of the shopmen's strike to the railroads is estimated at several hundred million dollars at least, the chief items outside of the loss of revenue being food and housing for new workers, the hire of guards to protect railroad property, and the high rate of labor turnover incident to securing an efficient force. The indirect cost of the strike, arising from inadequate repair work by inexperienced men, the contracting out of repair work, and the increased length of time necessary to make repairs, was also great. Both direct and indirect costs of the strike affected the net revenue of the railroads for 1922, and undoubtedly will have some effect on the net revenue during the greater part of 1923, because of repair work necessary to put in order the number of unserviceable cars and locomotives which had accumulated.

During the strike, which is still theoretically in force on many roads, the railroads have been handicapped by sabotage, by restriction of output, and by wilful destruction of property. The continuance of the strike has in all probability resulted in continued inefficient work and, in some instances, continued sabotage.

Unserviceable Cars

During 1922 the railroads were unable, because of the shopmen's strike, to reduce the number of cars awaiting repairs to the low level which is usually reached when traffic is heavy and the railroads have sufficient funds with which to carry on repair work. In the first place, due to the intense depression of 1921, when all expenses were reduced to a minimum and when as many repairs as possible were deferred until traffic revived, the number of cars to be repaired was large. Then the shopmen's strike of 1922 caused a temporary suspension of repair work, which was followed by the resumption of repairs at a rate which was for some time below normal. When the car surplus of 1919 gave place to a shortage which continued throughout 1920, the number of cars awaiting repairs dropped from the high point of 215,000 in July, 1919 to 150,000 in January, 1920, and fluctuated between 140,000 and 180,000 during the year of 1920. When, however, the surplus of 1921 and early 1922 disappeared and a shortage was reported, beginning in July, 1922, the number of cars awaiting repairs, which had risen to the unusually high figure of 380,000 on August 15, 1921, was reduced only to 215,000, that figure being reached on December 15, 1922, although the peak of the traffic movement came during the latter part of October.

Conscious of the seriousness of these conditions, the railroads of the country have determined to make a special drive to reduce the number of cars and locomotives awaiting repairs so that by October 1, 1923, when the heaviest movement of traffic of the year is expected, not more than 5% of the cars and 15% of the locomotives of the entire country will be awaiting repairs. These are normal figures under average conditions, but lower than have prevailed at any time since before the period of federal control. In this connection it should be noted that a car may be marked "bad order" and in need of repair when it may require only a slight amount of work at an expense of but a few dollars to put it in a serviceable condition.

Furthermore, some railroads have complained that they have been harassed by the activities of the Interstate Commerce Commission safety appliance inspectors in removing cars and locomotives from service on account of alleged defects. The railroad

labor unions, by demanding a special investigation of equipment by the Commission, tended to create a feeling throughout the country that the railroads were using equipment that was unsafe. This kind of publicity had its reaction in the increased activities of inspectors to detect and report defective equipment, whereas normally the inspectors' activities on any one railroad are only occasional. Some railroad executives have asserted that labor union members have been introduced into the inspection service of the Interstate Commerce Commission and that their activities have definitely harassed the railroads; but this is a matter on which it is difficult to obtain accurate information.

Car Shortage

During the period of the shopmen's strike, because of the increasing volume of traffic and piling up of bad order cars, the car surplus changed to a car shortage. On January 1, 1922, there had been a surplus of 475,000 cars, but on November 1, 1922, a shortage of 175,000 cars was reported. Since that date the shortage has decreased almost steadily until on July 31, 1923 a shortage of only 10,120 cars was reported, according to the Car Service Division of the American Railway Association.

The shortage of cars in November, 1922, was one of the greatest which ever existed in the United States. The large number of cars and locomotives awaiting repairs which were deferred from the light traffic year of 1921, and the shopmen's strike which prevented the railroads from catching up with their deferred repairs as rapidly as usual when traffic revived, were the principal causes of the car and locomotive shortage. Moreover, whenever a car shortage exists many shippers make a practice of ordering cars in excess of their actual needs in order to obtain enough to fill their requirements. To that extent the car shortage is usually overstated. Again, in many cases where cars are ordered which cannot be provided for loading on the morning following the order, but are furnished within a few days, a shortage is reported. Also, in one section of the country there may be a shortage of some classes of cars and a surplus of others, while in another section the opposite condition may prevail until equilibrium is established either by the movement of loaded cars or by the action of the Car Service Division of the American Railway Association in sending empty cars from sections of the country where there is a surplus into

sections where shortages exist. All these factors must be taken into account in fairly judging the extent and nature of an alleged car shortage; but the public mind usually fails to evaluate the situation in the light of these factors, largely because it is not informed of them. Due, however, to the progress made by the railroads in repairing unserviceable cars during the first seven months of 1923, and to the number of new cars delivered to the railroads, the car shortage has, as stated above, been materially reduced.

Lack of Facilities

A shortage of transportation facilities, rather than a shortage of cars, would better describe the present situation, since aside from shortage of locomotives and shortage of cars, inadequate terminal, yard, trackage, shop, and enginehouse facilities are all contributing factors.

The development of terminals and other facilities by the railroads has not kept pace with the needs of the country because of the difficulties under which the railroads have operated during recent years and because of their inability to raise the capital with which to make the improvements necessary adequately to handle the increasing amount of traffic. A heavy freight traffic taxes the capacity of the roads, especially at the terminals in large cities where less than carload traffic is received and delivered and where team track receipt and delivery of carload freight are made. The methods of handling freight through large terminals have not been sufficiently improved and adapted to the changing conditions of a larger volume of traffic and a greatly increased use of the motor truck as the connecting link between the railroad freight station or team track and the shipper or consignee, which has tended to increase terminal congestion. A more intensive use of the existing terminal facilities by the establishment of properly coordinated systems for the receipt and delivery of freight in large city freight stations through cooperative action of the railroads, shippers and teaming and trucking interests seems to offer a method of reducing terminal congestion without expense and without expanding the terminals themselves, most of which are situated in districts where property values are high and where, consequently, the cost of expansion would be prohibitive. Congestion at the terminals is far-reaching in its effect in that the ability of the

railroads to move freight on the line and through the classification yards is nullified to some extent unless the terminals are of proportionate efficiency.

Severe weather delayed the loading and unloading of cars by shippers and consignees at the terminals during the winter months. Embargoes and the failure of connecting roads promptly to accept cars routed over their lines have caused additional congestion. Inadequate facilities for the interchange of cars between railroads at connecting points, inadequate methods of passing freight through large city freight stations, inadequate engine terminal and shop facilities to permit the prompt repairing, turning, and releasing of locomotives as they are needed for service, and an insufficiency of double trackage, passing tracks, and sidings on the main lines are the principal limiting factors in railroad operation at present. In the responsibility for these defects the shippers share with railroad management, while the public through its legislative representatives is a contributory factor in the present impairment of railroad credit.

The railroads are not entirely responsible for the terminal congestion which has existed at various points during the past. In a number of cases where terminal facilities have been furnished by the public, as at New York, New Orleans and Boston, they have not been sufficiently expanded to meet the needs of the growth of traffic during recent years. Furthermore, sidetracks for many business establishments are not ample to care for the traffic of the concerns located on them, with the result that cars for those concerns must often be held back in railroad yards or on railroad sidetracks until place is made for them on the industrial tracks. In many instances the concerns located on industrial tracks request service from the railroads which is not at all consistent with the efficient operation of the railroads which serve them.

The plan of the railroads to expend $425,000,000 on additional trackage and other facilities during 1923 should provide some relief. Further improvements along this line will be dependent on the restoration of railroad credit which is looked for in the near future.

The Coal Strike

Coal constitutes normally about 34% of the total tonnage

carried by Class 1 railroads. The coal strike which commenced April 1, 1922 reduced the normal amount of coal traffic during the spring and summer months of 1922. In anticipation of the strike, coal loadings during the first three months of 1922 were, however, above normal. The loading of bituminous coal, which had increased from 140,000 to 210,000 cars a week from January, 1922, to the end of March, 1922, dropped to below 65,000 cars a week in April, and fluctuated between 65,000 and 100,000 cars a week until the settlement of the strike in August. Following the resumption of work by the miners, bituminous coal loadings for the week ending September 2, 1922 were 170,000 cars and increased steadily until, for the week ending December 9, 1922, 210,000 cars were loaded. In a similar manner, anthracite loadings, which just before the strike amounted to 40,000 cars a week, dropped to almost nothing for the entire period of the strike, although usual loadings for that period of the year average from 28,000 to 38,000 cars a week. In and after September, 1922, however, loadings increased until they reached the high mark of 42,000 cars loaded during the week ending November 18, 1922. The effect of the coal strike on the railroads, therefore, was to throw out of balance the coal traffic during 1922. During the period of the strike no anthracite was shipped and only from one-third to one-half the usual amount of bituminous coal was shipped, whereas both before and after the strike the rate of coal loadings was above normal for these seasons of the year.

The coal shipments in the fall of 1922 were less than during the same period of 1920, the record year, but were much greater than those during the fall of 1921. If shipments of coal during 1922 had been in proportion to those of other commodities in that year, 1922 would have been a record year for freight traffic. Loadings of all commodities except coal in 1922 were 36,266,000 cars; in 1920, 35,036,000 cars. Coal loadings in 1922 were 7,448,000 cars; in 1920, 10,082,000 cars. In this connection it is interesting and encouraging to learn that for the year from July 1, 1922 to July 1, 1923, the volume of traffic, as indicated by the number of car loadings, has been far greater than during any corresponding period in the history of the country.

The difficulties of the railroads, especially in the northern part of the country, were aggravated by an unusually severe winter which necessitated the use of a part of the motive power which

ordinarily is assigned to freight service, in clearing the road of snow and in assisting passenger trains. Although during every winter, because of low temperature, freight train loads are reduced, the effect of the winter of 1922–1923 was especially severe, more because of the abnormal accumulation of snow and ice than because of abnormally low temperatures. Its severity is reflected in the net earnings of the New England roads for January, 1923, and of all the northern roads for February and March, 1923. In consequence of the severe weather conditions, the movement of freight was delayed, and the shortage of cars was intensified by the lack of motive power. Furthermore, the poor quality of the coal obtainable because of the scarcity of good fuel as a result of the coal miners' strike and the necessity of using inferior grades caused additional delays in freight train movement.

Shippers' Practices

Whatever may be the responsibility of railroad management or labor for the unsatisfactory railroad service, the shippers are responsible for certain practices which react unfavorably upon the efficient operation of the railroads. Many shipments made under "to order" bills of lading are held in the cars for long periods until a buyer is found for the shipment, or because the buyer lacks the credit to lift the consignment. Frequently also when traffic is heavy many consignees do not have sufficient warehouse room to care for all the freight which is consigned to them, with the result that the freight is not unloaded until the consignee finds warehouse room for it. Moreover, the reconsignment privilege, by which the destination of a car may be changed en route, is a detrimental factor in car shortage and in railroad expense because it generally causes delay while the reconsignment is being made, and in many cases it necessitates hauling the car back over part of the route which it has already covered.

To eliminate these obstacles to efficient car movement, the railroads have recommended that the reconsignment privilege be limited as far as possible in order to save the accounting expense incurred, as well as the time—and consequently the use of the car—lost in making reconsignments. It is also urged by the railroads that shippers load cars to capacity whenever possible in order that the greatest efficiency in the use of cars

may be obtained. However, commercial requirements should be taken into consideration. When consignees require a certain amount of material for a specific purpose, they should not be asked to order more than their actual requirements or the amount specified by the railroad tariffs as the minimum necessary to obtain the carload rate, but whenever practicable, goods should be ordered and shipped by the carload, rather than by specific quantities which may not be sufficient to make a carload.

More Remote Causes

Repressive Regulation

The more remote causes of car shortage and delays to shipments are the results of the system of regulation to which the railroads have been subjected since 1887. Until the passage of the Transportation Act of 1920, the attitude of the Government was repressive rather than constructive, from the point of view of railroad operation. In spite of the steady increase in commodity prices from 1900, the Interstate Commerce Commission refused to allow the railroads to increase their rates to meet the higher price levels. In 1914 the carriers in the East were allowed a 5% increase in rates; in 1917 they were allowed a 15% increase; and in 1918 an increase of approximately 25% was granted to all carriers. These increases, however, did not compensate for the steadily increasing cost of operation. Although economies in operation were effected, the railroads were unable to make the improvements which were necessary to keep up with the increase of traffic due to the normal growth of the country. Furthermore, the restrictions put upon the railroads by both state legislatures and Congress have been constantly growing until there is cumulative evidence that railroad development is in danger of being choked by extreme regulation which is against the best interests of the people as a whole.

Deferred Maintenance

Under federal and state regulation the railroads as a whole have not earned returns adequate to permit the expenditures necessary to keep their plants and equipment in the best condition at all times. During periods of heavy traffic, returns in many cases are not sufficiently ample to permit setting aside a surplus out of which to keep up maintenance when traffic is light and returns are scanty. Consequently, during the latter

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periods most railroads are required to cut their expenditures down to a minimum, especially those for maintenance of way and structures and maintenance of equipment. Repair work is deferred until more prosperous periods. When traffic revives and the demand for equipment increases, in order to release all possible equipment for service, repairs are hurriedly made, often inadequately, and generally at a greater cost than would have been the case if they had been made during the dull period. A large part of the present car and locomotive shortage is due to this forced policy of deferred maintenance by the railroads.

Inadequate Return

The ton mileage of the country doubles every ten or twelve years. In order to handle this increasing volume of traffic, the railroads should be constantly improving and adding to their plant and equipment. To do this requires a continual infusion of new capital, yet the rate of return from railroad investment has not been sufficient to attract this new capital. Most of the railroad financing of the last few years has been through bond issues, with the result that the financial structure of many roads is top-heavy due to the disproportionate amount of bonds outstanding in relation to the capital stock. A large part of the recent financing by the railroads has been for the purchase of new equipment through equipment trust bonds or certificates. The purchase of equipment by this means is relatively easy to finance, regardless of the credit or financial standing of the railroads involved, because the equipment trust certificates generally constitute a mortgage on the equipment purchased and consequently are sound investments. The usual procedure is to take up these bonds or certificates in equal amounts each year for ten or fifteen years, at the end of which period the equipment is owned outright by the railroad. Since the life of the average locomotive or car is longer than fifteen years, the amount of bonds outstanding on any purchase of equipment is reduced more quickly than the equipment depreciates or becomes obsolete.

On the other hand, the financing of additions or betterments, other than equipment, presents greater difficulties to the average railroad, and the ability of the railroad to accomplish such financing is dependent on its financial condition and the strength of its credit. Due to the inadequate return on railroad invest-

ment during the past years, the railroads as a whole have been unable to finance and provide themselves with the necessary terminals, trackage, shops, and other facilities adequately to handle the normal traffic of the country.

Federal Control

Federal control from January 1, 1918 to March 1, 1920, during a large part of which period everything was subordinated to winning the war, put a stop to many proposed improvements and left the railroads in a weakened condition, especially as to plant and equipment. Moreover, many railroads have not yet been able to come to an agreement with the Director General on the settlement of claims against the Government arising from the operation of the railroads during the period of federal control, the chief obstacle being the inability of the railroads and the Director General of Railroads to agree upon a fair basis for such settlement; and only a few railroads have settled with the Interstate Commerce Commission for the "guaranty period," from March 1, 1920 to September 1, 1920.

Railroad Valuation

The Railroad Valuation Act of 1913 instructed the Interstate Commerce Commission to investigate, ascertain, and report the value of all the property owned or used by every common carrier subject to the jurisdiction of the Commission, giving in detail the original cost to date, the cost of reproduction new, and the cost of reproduction less depreciation of each piece of property owned or used. This Act was passed through the efforts of certain members of Congress who believed the railroads to be over-capitalized; and it was intended to "squeeze the water" out of the railroad stocks. The valuation work has proceeded at great cost both to the Government and the railroads and is now nearly complete. Final valuations of some railroads have been published and tentative valuations of many other railroads have either been completed or are nearing completion. With few exceptions, the figures published by the Commission show that the value of the railroad property used in the service of transportation is equal to or greater than the total capitalization outstanding against such property; in other words, that there is no "water" in railroad capitalization. Yet, in spite of the results of the valuation study, many of the legislators through whose efforts the Valuation Act was passed,

assert that the valuation has not been fairly made and that the value of the property of the railroads in the United States is in the vicinity of $12,000,000,000 instead of the figure of $18,900,000,000 which the Commission established in 1920 as the basis of rates.

The Transportation Act of 1920

The Transportation Act of 1920 opened a new era of railroad regulation. During the period of federal control it was recognized that the Act to Regulate Commerce and its amendments, under which the railroads had been subject to government regulation since 1887, were no longer adequate, and that a new and improved method of regulation should be devised to permit the railroads to grow and provide the service necessary for the entire country. The Transportation Act, which was approved by the President February 28, 1920, after more than a year's discussion in Congress, and became effective March 1, 1920, recognizes that many practices formerly prohibited by regulatory laws are essential for the welfare of the railroads. In addition to providing for the return of the railroads to private control, there are three important provisions in the Transportation Act—the new method of fixing rates, the establishment of the Railroad Labor Board, and the provisions for the consolidations of railroads.

The fundamental difference between the Transportation Act and previous laws of regulation is that, while the Transportation Act continues to vest in the Interstate Commerce Commission the power to require reasonable rates, to prevent discrimination by the railroads against individuals or communities in the making of rates, and to prevent deliberate mismanagement of the railroads, and in addition strengthens the power of the Commission over railroad finance and service, it recognizes that the authority to regulate must be accompanied by the responsibility for the effects of that regulation upon the railroads. This new fundamental of regulation is illustrated by the rate-making provision of the Act which states that railroad rates shall be established on such a basis as to enable the railroads as a whole or by groups "under honest, efficient, and economical operation" to earn "as nearly as may be" a reasonable rate of return upon the aggregate value of their properties held for and used in the service of transportation, and which further directs the Com-

mission in determining what percentage of the railroads' property value the fair return shall be, to give due consideration among other things to the transportation needs of the country and the necessity of enlarging the existing transportation facilities in order to provide the people of the United States with adequate transportation.

The Act established 5½% of the aggregate value of the railroads' property as the fair return for the two years beginning March 1, 1920, to which the Commission in its discretion might add one-half of one per cent on such aggregate value to make provision in whole or in part for improvements, betterments, or equipment chargeable to capital account. The rate increases of 1920 were intended by the Commission to yield a return equal to the full 6% on the value of the property of the railroads devoted to transportation. The Commission is further instructed to determine from time to time what constitutes a fair return, and accordingly, in 1922, it ruled that 5¾% should be a fair return for the two years subsequent to March 1, 1922.

Under the Transportation Act any railroad which earns for any year a return in excess of 6% on the value of its property held for and used in the service of transportation must place one-half of such excess in a reserve fund established and maintained by such railroad and must pay to the Commission the other half for the purpose of establishing and maintaining a general railroad contingent fund to be used in loans to such railroads as need funds for capital use or to retire securities.[1] Control over all security issues by the railroads is given to the Commission by the Act, which provides in this connection that any railroad wishing to issue capital stock, bonds, or other evidences of indebtedness, or to assume any obligation or liability in respect of the securities of any other person must obtain the authorization of the Commission after making application in the prescribed form. Thus, the Transportation Act through its provisions as to rates, excess earnings, and security issues gives the Interstate Commerce Commission almost complete financial control of the railroads.

[1]Although the Interstate Commerce Commission is required by the Act to determine from time to time what constitutes a fair return, and has set the figure of 5¾% for the two years beginning March 1, 1922, the Act specifies that one-half of the earnings of any railroad in excess of 6% for any year shall revert to the Commission, and not one-half of the earnings in excess of the fair return, as is commonly believed. The Act is not clear as to the disposition of earnings which are in excess of the fair return, but not in excess of 6% on the property value, at times when the fair return is set below 6%, as it is at present.

In the section dealing with disputes between carriers and their employees and subordinate officials, the Transportation Act provides for the establishment of the Railroad Labor Board to settle disputes over wages and working conditions between the employees and the managements of the railroads in the event that satisfactory agreements cannot be reached between individual roads or groups of roads and their employees. The board is composed of nine members appointed by the President, with the consent of the Senate, three representing the employees, three representing the managements, and three representing the public. The establishment of the Labor Board provides a method by which differences may be adjusted between the employees and the managements without interrupting transportation. Although the board has no power to enforce its decisions, they have been generally respected and obeyed.

The Transportation Act directs the Interstate Commerce Commission to prepare and adopt a plan for the consolidation of the railroads of the United States into a limited number of systems in which "competition shall be preserved as fully as possible and wherever practicable the existing routes and channels of trade and commerce shall be maintained. Subject to the foregoing requirements, the several systems shall be so arranged that the cost of transportation as between competitive systems and as related to the values of the properties through which the service is rendered shall be the same, so far as practicable, so that these systems can employ uniform rates in the movement of competitive traffic and under efficient management earn substantially the same rate of return upon the value of their respective railway properties."

The Transportation Act has brought about a change in the relation of the Interstate Commerce Commission to the railroads in that, for the first time, the Commission is required to fix a rate schedule sufficient to yield the roads a fair return on their valuation. Thus far, the Transportation Act has been the most constructive railroad legislation enacted, for it recognizes that the railroads are entitled to a fair return on their property investment. Prior to the passage of the Act, the Interstate Commerce Commission had no guide in establishing rates other than to keep them as low as possible, with the result that the railroads were obliged in many cases to contest rates that were confiscatory.

The opinion of railroad executives as to the value of the Act is by no means unanimous, some executives contending that the figure set as a fair return by the Interstate Commerce Commission under the provisions of the Act is confiscatory in that it is too low to be a really fair return when compared with the returns earned by private enterprises. The practice, originated under federal control and continued by the Railroad Labor Board, of setting a single rate of wages for each class of employees throughout the country, regardless of differences in the cost of living and labor conditions in various sections, has evoked criticism both from railroad executives and manufacturers as an unsatisfactory condition which has arisen from the Transportation Act. As a result of this practice, it is asserted, in some districts railroad employees have from time to time been overpaid as compared with workers in outside industries.

The "recapture clause" of the Transportation Act under which one-half of the earnings of any railroad in excess of 6% on the valuation for any year shall revert to the Interstate Commerce Commission has aroused much opposition on the part of some railroad executives. It is contended that this clause has a bad moral effect in that, for the roads which are capable of earning more than the fair return, it tends to destroy the initiative to operate in the most economical manner, because of the knowledge that part of the earnings above those fixed by law will be taken from them, and further, because of the fear that it may be used to assist a competitor who is in a less satisfactory financial condition. Furthermore, it is claimed, it has a tendency to discourage the weak roads from operating most efficiently and economically because of the knowledge that they may be given financial assistance. On the other hand, the framers of the Act intended that the recapture of excess earnings by some such method as is provided by the Act would make easier for the Commission the problem of fixing competitive rates for strong and weak roads alike so that the earnings of both classes of roads might be equalized to some degree.

The Transportation Act up to the present has not brought about the results anticipated at the time of its passage. The railroads as a whole have not during any year since their return to private control earned the amount set as a fair return. The period since the termination of federal control has been marked by many abnormal conditions in railroad operation. An increase

in wages was granted to all classes of railroad employees in June, 1920, retroactive to May 1, 1920, although part of that increase was taken away July 1, 1921. During 1922, further wage reductions were put into effect, covering all employees except those engaged in the actual movement of trains. Changes were also made in rules and working conditions during 1921 and 1922 which had the effect of a wage reduction. Not even by these decreases and changes, however, were the wages of all employees reduced to the level of those in outside industries at those times. High material prices and high wage costs since March, 1920, an industrial depression during 1921, a revival of traffic in 1922 which found the railroads lacking in facilities with which to handle it, the coal miners' strike and the shopmen's strike have combined to prevent the attainment of the results anticipated by the Transportation Act. During 1921, assisted by deferring maintenance and by the strictest economy otherwise, the railroads earned a return of 3.68% on the tentative valuation set by the Interstate Commerce Commission. In 1922, traffic revived strongly and the roads earned 4.14% on that valuation.

A fair trial of the Transportation Act under normal traffic and industrial conditions may yet enable the railroads to earn a fair return on their valuation, and thereby to restore their credit and attract new capital with which to improve their facilities and to increase their equipment so that efficient movement of traffic may be accomplished at reasonable rates. The results attained during the closing months of 1922 and during the first six months of 1923 appear to indicate that the roads are improving their situation by reducing their operating expenses in proportion to their income, and as the effects of the coal and shop strikes wear away and the roads are not handicapped by adverse weather conditions, a still better showing may be expected. The favorable results of the last few months must be discounted by the large amount of traffic which is being moved. It would be difficult to say what showing the railroads would be making if traffic had not increased to its present unprecedented volume.

The majority of railroad executives and a large part of the business interests of the country desire the retention of the Transportation Act in order that it may be given a fair trial. Some railroad executives believe that the railroads as a whole

will be able to earn an amount approximating the "fair return" this year, provided that no unforeseen labor or industrial crises arise to prevent the attainment of this result. In support of this belief, the railroads have pledged themselves to spend approximately $1,100,000,000 during 1923 for new cars and locomotives, and for additional trackage and other facilities in order that they may handle expeditiously the heavy traffic which is expected to reach its peak for the year by October, 1923. It is the opinion of some railroad executives, however, that the repeal or the amendment of the Transportation Act should be sought in the next Congress, but the majority opinion is against any attempts in that direction and for giving the Act a fair trial during the next two years, in the hope that during that period such favorable results may be attained that railroad credit will be restored, rates lowered without impairing earnings, and consequently any further legislation rendered unnecessary.

III

RATES

Basis of Rates

Many aspects of the situation as to rates have been touched upon above in the discussion of service. The Interstate Commerce Commission is empowered by the Transportation Act to put in force a schedule of rates sufficient to allow the railroads, under honest, efficient and economical operation, to earn a fair return on the value of their property devoted to the service of transportation. For rate-making purposes, the country is divided into four districts, in each of which the rates are fixed on a basis estimated to yield a fair return to the roads. Within each district, however, there are strong and weak roads. A schedule of rates which would allow the strong roads to earn only a fair return would put the weak roads into bankruptcy, and one which would allow the weak roads to earn a fair return would bring the earnings of the strong roads to a high point. Since, in many cases, weak and strong roads exist side by side in direct competition, different rate schedules for the two classes of railroads seem out of the question. To meet this situation the Transportation Act provides for a plan of consolidation under which the earning power and financial strength of the various systems would be about equal, thus offering, if it could be carried out on a basis which would not be unfair or unreasonable, the most logical method of equalizing the financial and operating characteristics of both strong and weak roads. It may, however, prove difficult to devise such a system without unfairness to some of the railroads and their stockholders.

Effect of Present Rate Schedules

Thus far the rates in effect have failed to net the railroads as a whole a fair return, due to a large extent to the abnormal conditions which have prevailed since the present rate schedules were put into effect. The causes stated above—high wage costs, high material prices, poor traffic during 1921 and part of 1922, and the lack of adequate facilities—have contributed to this

condition. Although the present industrial revival has taken place in spite of the freight rates now in effect, which are protested as being high, public opinion seems clearly opposed to further increases in freight rates. Shippers throughout the country, especially in the agricultural sections, are complaining that present rates are oppressive.

Some railroads, however, are earning a fair return under present schedules, but their number is not large and is composed of the roads which are in a strong geographical, commercial and financial position. If the experience of the near future shows that the railroads can earn more than a fair return on their valuation, it will then be time to consider rate reductions. The results of the first six months of 1923 show that earnings of Class 1 railroads were at the rate of 5.64% on the tentative valuation fixed by the Interstate Commerce Commission, in contrast to 4.53% for the same period of 1922. The unusually severe winter had a material effect on the operating results of the New England roads in January and of all the roads in the northern part of the country in February and March. It is hoped that results for the remainder of the year will be better, provided that the volume of traffic does not diminish materially and that operating expenses are not increased by augmented wage costs, etc.; and it is possible that a fair return basis may be reached.

But it must be remembered that, if private capital is to be attracted into the railroad business—and this is necessary if the railroads are to improve their facilities to meet the growth of traffic—it must be granted an adequate return. Such a return is possible only if the railroads are allowed rates which will bring in adequate funds, and if they are subjected only to a reasonable amount of regulation under which the initiative of workers and management will not be curbed.

Rate Changes

During the period of federal control and since, by order of the Interstate Commerce Commission, horizontal rate changes have taken place by which all rates are raised or lowered to the same relative extent. Since freight rates have but slight influence on the price of articles of relatively high value and, on the other hand, are of major importance in the price of lower-grade, bulky commodities, it is the opinion of railroad executives

and of the majority of shippers that freight rate changes should not be made by horizontal increases or decreases but should be made in such a way as to have the most favorable effect both on the volume of traffic and on commodity prices on which the volume of traffic is to some extent dependent. Many freight rates include arbitrary differentials, and it is generally considered important that such differentials should vary in proportion to the changes in the rates to which they are added. Furthermore, industrial conditions vary from time to time both as between industries and between various sections of the country. It appears, therefore, that rate changes should follow a plan which would be fair to all industries and all commodities, and in which the relations and the spread between rates for various articles and classes of commodities would be proportional.

Scientific Basis of Rates

The present rate structure of the country is not on a scientific basis. It is the outgrowth of rates which were put into effect years ago to promote the growth of undeveloped sections of the country, to equalize the advantages of various sections in the same markets, or to allow the railroads to compete with water transportation, which in many cases has since ceased to be active. Consequently, mileage is not the controlling factor in a large proportion of the freight rates. Furthermore, low commodity rates have been made in many instances in order to attract the movement of bulky commodities of low value, which would not be shipped except under low rates. With the growth of the country and the development of many hitherto undeveloped districts, the basis of rates has remained unchanged to a large extent. Naturally, any attempt to put into effect a more scientific system of rates than now exists will meet with considerable opposition from the communities and sections which are favored by the present rate structure. Nevertheless, it is most important that a rate structure based as far as possible on mileage, but giving other factors due consideration, should be installed throughout the country, in order that industry in all sections may be put on an equitable basis in this regard, and that no one section will have rates that will give it an unfair advantage over other sections. In the many individual rate

adjustments which are constantly being made by railroads throughout the country, however, the tendency for some years has been to give the mileage factor greater consideration. It would be necessary, however, to continue to ignore mileage as the controlling factor in rail rates which would be made in competition with water rates, since rates by water are ordinarily less than rail rates between the same points.

IV

CONSOLIDATIONS

As already stated, the consolidation of the railroads of the United States into a limited number of systems is advised by the Transportation Act, and the Interstate Commerce Commission is directed to prepare and adopt a plan of consolidation. The Commission has had drawn up and made public a tentative plan of consolidation upon which hearings have been held.[1] The underlying purpose of the consolidation of railroads is to bring strong and weak roads together into systems that will be as nearly alike as possible in size and earning power in order that the weak roads of the country may be strengthened by alliance with stronger roads and thus be enabled to operate more efficiently and economically, and that the economies of unified operation may ultimately bring about a reduction in rates. Under the present method of fixing rates, the earnings of strong and weak roads vary greatly.

The attitude of some railroad officials toward any plan of consolidation is one of opposition. It is only natural that the strong roads should object to sharing their earnings and the resources which they have built up over a period of many years with other roads which may have been competitors in the past and which have not been able to put themselves on as firm a basis as the strong roads because of mismanagement or lack of foresight, or because of poor traffic resources. The profitable operation of the weak roads, however, is as vital to the communities which they serve as that of the strong roads, and the consolidation plan is offered as a means of bringing about the profitable operation of those weak roads, although its likelihood of doing so is a matter on which considerable doubt has been expressed by railroad executives and others. Certain economies might result from the unified operation of railroads under a system of consolidation, such as the lessening of delays

[1]See National Industrial Conference Board, "The Consolidation of Railroads in the United States," Research Report No. 56, in which the tentative plan of the Commission and the plan submitted by John E. Oldham, a Boston banker, are analyzed, discussed and compared.

in the interchange of cars, the elimination of much interline accounting, and more economical terminal operation. Although such economies would be important, it is doubtful if they would be sufficient to permit any substantial reduction of freight rates.

The Transportation Act, in permitting consolidations, completely reverses the Government's former policy in this regard as embodied in the Sherman Anti-Trust Law. This policy has hitherto prevented many consolidations which otherwise would have been made during recent years. The accomplishment of the purposes of consolidations as permitted in the Transportation Act requires that they should be allowed to follow as far as possible the natural lines which they might have followed had they not been restricted in the past. In making voluntary consolidations, it may not be thought desirable by the strong railroads to include many of the weak roads in the new systems because of their poor financial condition or their poor traffic resources. Several years may be required to work out voluntary consolidations satisfactory in the public interest.

If the railroads are allowed by the Interstate Commerce Commission to make voluntary consolidations, when such consolidations as may be found desirable have been completed, provision may then be made to gather up the loose ends and include in the resultant systems roads which are still independent. The difficulty of including many of the weak roads in the consolidated systems upon terms satisfactory to the managements and stockholders of both the larger systems and the roads to be absorbed is one of the many obstacles to a country-wide consolidation program. Furthermore, there are throughout the country many railroads and branch lines which are no longer profitable to the companies which operate them. With improved highways, the automobile truck and passenger bus are capable of serving adequately the communities on many of these lines. Their continued operation serves no economic purpose, but really constitutes an economic waste.

The plan of consolidation which is advocated by the Interstate Commerce Commission is opposed by many railroad executives, partly on the ground that it would force railroads to make alliances which in many cases would not be conducive to more economical operation and which would deprive many railroads of important connections with which at present they have close

traffic relations. Furthermore, many shippers and communities oppose the consolidation plan presented by the Commission for fear that large, unwieldy systems will be built up which, in addition to lessening competition, will give less satisfactory service than the present roads. If the railroads are allowed to consolidate along natural lines, or if the Commission should be given authority to allow consolidations upon application of interested railroads, when they are considered to be in the public interest and not destructive of competition, much of the present opposition on the part of railroad executives, shippers, and the public may disappear.

V

OTHER FACTORS

Standardized Shop Operation

In shop operation and repair work, many railroads have not installed modern machinery and methods. Maintenance and repair costs are higher on such roads than on those on which modern shop methods are employed. It seems essential, in order to provide honest, efficient and economical operation as required by the Transportation Act, that all railroads be equipped as early as it may be practicable with modern machinery and shop methods, and that they adopt the principles of scientific management so far as they can be applied to railroad work. Yet the railroads have been prevented in past years from installing modern machinery to a greater extent than they have done, largely because of their inability to earn a sufficient return to attract the necessary capital.

Motor Truck Competition

The motor truck has made rapid strides during recent years in transportation over reasonably long distances. Since the truck is limited in its load to what would be less than a carload for the railroads, for short hauls it may perform an auxiliary service to the railroads for whom short-haul and less than carload traffic are expensive to handle. The motor truck is, however, becoming a direct competitor for longer distances in some parts of the country. Many railroad executives assert that the motor truck and bus are making serious inroads into the earnings of their railroads. It should not be forgotten that the present system is one under which the railroads pay taxes which in part are devoted to the construction and maintenance of the highways over which the trucks operate, while the trucks contribute nothing to the construction and maintenance of the railroads' rights of way. The railroads, on the other hand, through grants of land by federal and state governments and through their franchises under which they have exercised the right of eminent domain, have obtained from the public concessions which do not admit of accurate valuation. An investi-

gation into this subject to determine whether or not the railroads should justifiably be released from paying road taxes would be of great value in clearing up this moot question. It is generally agreed that motor truck owners, property owners, and all others deriving benefit from the roads should be taxed on an equitable basis. Whatever are the conclusions reached and whatever their effect on the railroads and the motor trucks, the shippers will ultimately use that transportation facility furnishing the best service at the least cost, all things being considered.

Employee Relations

The Railroad Labor Board as authorized by the Transportation Act was formed shortly after the railroads were returned to private operation on March 1, 1920. It commenced functioning immediately and has decided a large number of cases ranging from the matter of disciplining a single employee to ordering wage increases or reductions for all employees. The Board has no power to enforce its own decisions, but may, after due notice and hearing to all persons directly interested in the violation of any of its decisions, determine whether in its opinion such violation has occurred and make public its decision in such manner as it may determine. Since the formation of the Labor Board there have been violations of its decisions both by the railroads and by the employees, but on the whole the decisions have been respected and obeyed. Since the settlement of the shopmen's strike of 1922 on many roads the tendency has been toward the adjustment of differences between employees and managements by individual railroads without bringing them to the Labor Board, an indication of increasingly closer relations between the railroads and their employees.

Nearly all large industries have found that the establishment of personnel departments has improved their relations with their employees. The railroad transportation industry is second in size only to the agricultural industry, and while it differs from many other industries in that its workers are scattered over large areas, close working relations between management and its employees would here as there work out to the greater benefit of both. Several railroads have already established personnel departments, but progress in this direction has had to be cautious

because of the strength of the railroad labor unions and their natural antipathy to anything tending to interfere with their influence and power. Some railroads have successfully organized their employees into independent unions to which only employees of the respective roads can belong and whose spokesmen are in constant touch with the management. Others are working out other means of close working relationship with their employees and all clearly recognize that high morale throughout the entire working force of officials and men in the ranks is necessary for the success of the railroads as an industrial undertaking and as a public utility. This cannot be brought about if the railroads are over-regulated to such an extent as to develop the feeling in the minds of the officials that initiative and incentive are of no avail, for that feeling would soon take hold of the employees, to the detriment of efficient and successful operation.

Public Relations

The railroads of the country as a whole do not adequately put before the public the commodity which they have to sell, i. e., service. Some notable exceptions may be cited, but the railroads have not developed the close contact with the public which other public service organizations, particularly the telephone and electric light companies, have made. This might be overcome if the railroads were to organize a campaign to put their service before the public, and were to take the initiative in finding out what service their patrons want, and in providing that service as fully as is possible and consistent with economical operation. Service bureaus with offices at convenient locations might be established for the hearing and speedy adjustment of complaints. Chambers of commerce and traffic organizations have been the principal points of contact between the railroads and the shippers, but they have been limited in their scope to the discussion of general problems. Furthermore, many shippers, especially small shippers, do not belong to any of these organizations. Due to the time and labor involved, many petty problems of shippers are never brought to the railroad executives' attention, with the result that railroads are thought to be unreliable and inefficient by many shippers, because certain practices go uncorrected through ignorance of their existence on the part of those railroad officials who have power to remedy them. Nearly all contact between

the railroads and the shippers has been actuated by the shippers, either individually or through their associations. The railroads should take the initiative in this respect by affording shippers convenient opportunities to present their problems and by speedy adjustment of them in so far as their correction is in accord with efficient and economical operation. There are, however, some railroads which have established closer and more cordial relations with their shippers by active cooperation with them and adjustment of their problems, but the number of these roads is small. The action of the American Railway Association in establishing Regional Advisory Boards in various sections of the country for the purpose of effecting greater cooperation with the shippers is a constructive step in this direction, the success of which will be noted with interest. These boards are composed of the district managers of the Car Service Division of the association, representatives of the railroads, and committees representing the shippers in each section. Regular meetings are held at which matters of importance both to the shippers and to the railroads are discussed.

The railroads are striving to reduce their unserviceable cars and locomotives to a normal basis, and to attain thirty-mile per car per day and thirty ton per car averages for the country as a whole during 1923. The hearty cooperation of the shippers in loading cars to capacity, in the prompt loading and unloading of cars, in ordering only as many cars as they actually need, and in shipping as much of their freight as possible before the fall traffic peak, is necessary in order that the railroads may reach the mark which they have set. A proper solution of the whole transportation problem depends, to a large extent, on a closer cooperation between the shippers and those who direct our transportation facilities, rail, water and road in order that the country may have a well-coordinated, efficient transportation system. If the railroads, assisted by the earnest cooperation of the shippers, are able to provide satisfactory service throughout the period of heavy traffic which is expected to continue into the late fall of this year, they will have a strong argument to combat any hostile and more restrictive legislation which may be introduced in the next Congress. Such legislation would be disadvantageous to the country as a whole as well as to the railroads, because the prosperity and further growth of the country are interwoven with the successful operation of the railroads.

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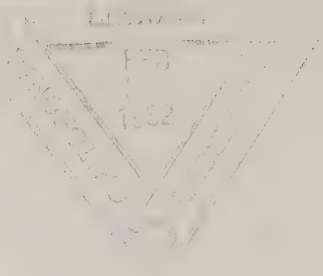

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